

# Frequently Asked Questions for Tier 3 Not-for-Profit Entities

Assessing and reporting on your entity's ability to continue operating

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## Introduction

We have put together this series of FAQs to help the governing bodies of Tier 3 not-for-profit entities understand their responsibilities to assess and report on their entity's ability to continue operating.

In periods of increased uncertainty (such as that caused by COVID-19), providing information on your entity's\* ability to continue operating is an important part of helping readers to understand your performance report.

The FAQs highlight and refer to the requirements from the [Tier 3 Standard](#)\*\*

\* References to an 'entity' should be read as reference to a Tier 3 not-for-profit entity (including registered charities).

\*\* Full title of the Tier 3 Standard is Public Benefit Entity Simple Format Reporting – Accrual (Not-For-Profit)

\*\* Public Benefit Entity Simple Format Reporting – Cash (Not-For-Profit) which applies to Tier 4 not-for-profits includes no specific requirements for an entity to report on its ability to continue operating.



## Requirements of the Tier 3 Standard

### General requirements

The Tier 3 Standard requires you to include in your entity's performance report\* any information that you consider necessary to understand your entity's overall financial performance and position.

This usually includes any important information you know about your entity's ability to continue operating.



*See paragraphs A11, A81, A149, and A213 of the Tier 3 Standard*

### Specific requirements

The Tier 3 Standard includes two specific requirements to provide information about your entity's ability to continue operating.

The statement of accounting policies requires you to state whether or not your entity's performance report has been prepared assuming that it will continue to operate for the foreseeable future.

If your entity plans to stop operating within 12 months of your financial year end, or it is likely that it will have to, in the notes to your performance report you are required to:

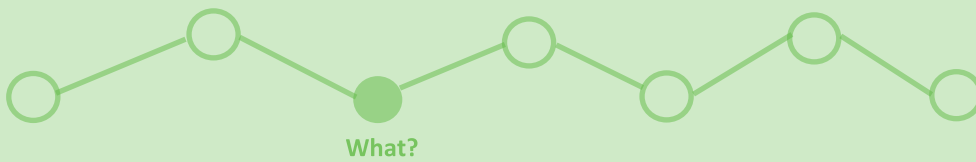
- (a) state that;
- (b) explain why you intend to stop operating or may not be able to continue operating; and
- (c) estimate the effect this could have on the recorded amounts of your entity's assets and liabilities.



*See paragraphs A175, A176, A210 and A211 of the Tier 3 Standard*

For those who need more information the remainder of this document answers questions about what these requirements mean and how to apply them.

\* Performance report refers to the annual report which includes both the entity's financial and non-financial information.



## *What do we mean by an entity's ability to continue operating?*



### **What does the Tier 3 Standard mean by ability to continue operating?**

In simple terms, an entity has the ability to continue operating if:

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- It **intends** to continue operating for the foreseeable future; and
- It is **able** to continue operating for the foreseeable future.

Foreseeable future usually means a period of at least 12 months from the date the entity's financial year ends.



### **We have heard about the going concern concept, is this the same as the ability to continue operating?**

Yes, the principle is the same. The Tier 3 Standard just uses simpler language to describe the same concept. To say an entity is expected to "continue operating for the foreseeable future" is the same as saying the entity is expected to "be a going concern for the foreseeable future".

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### **When would an entity not be considered to have the ability to continue operating?**

Under the Tier 3 Standard, an entity is considered **not** to have the ability to continue operating in only two specific circumstances. It requires the governing body to either:

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- decide to cease operating ("wind-up") within the next year; or
- to have no realistic alternative except to cease operating ("wind-up").

Even in difficult times, most entities are likely to be able to continue operating by being careful about how they spend their money or by changing how they do things.

In a nutshell, an entity is thought to have the ability to continue operating unless it expects not to exist within the next 12 months.



*See paragraph A176 of the Tier 3 Standard*

## *Why is it important for an entity to report on its ability to continue operating?*

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### **Why is assessing and reporting on our entity's ability to continue operating important?**

In the "good times" assessing and reporting on your entity's ability to continue operating is often simple. In many cases it's ok to assume that everything will continue as normal.

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However, during difficult times, assessing and reporting on your entity's ability to continue operating is both more challenging and important.

Good reporting about your entity's ability to continue operating helps your donors, members, funders, beneficiaries, and the wider public understand how you've been affected and your plans to get through the difficult period.

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### **Why is the ability to continue operating considered a part of preparing our entity's performance report?**

Even though your performance report is mostly about what has already happened, it can still be affected by what happens in the future. Many items in the performance report are recorded assuming that your entity will continue operating. If you can't assume that, some of those items may need to be recorded at different amounts.

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For example, you would normally record inventory at what it cost you to purchase. But if you think that you will need to wind-up and sell the inventory quickly, you may need to record the inventory at what you expect to receive from sale instead.

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### **Is it because of COVID-19 that we have to assess our entity's ability to continue operating?**

No this is not a new requirement, but we are aware that the COVID-19 pandemic is having a significant effect on everyone. Part of this can be that you will need to spend more time thinking about your ability to continue operating and how you are going to explain your thoughts to the readers of your performance report.

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## *How do you assess your entity's ability to continue operating?*



### **How do we decide whether our entity has the ability to continue operating?**

Because every entity is unique, there's no "one size fits all" rule you can use in every case. This means that your entity's governing body will need to make some judgement calls based on the information known when approving the performance report.

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A good starting point for making your assessment is to prepare a cash flow forecast for the next financial year. A cash flow forecast is an estimate of the cash you expect to receive and the payments you expect to make during this time. Having a cash flow forecast helps you to form a view on whether your entity is going to have enough cash coming in to pay for all its costs.

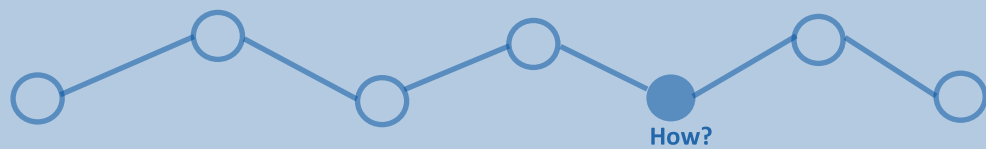
Below, we have listed some key factors and some questions to ask yourself when assessing your entity's ability to continue operating. It is not intended to be a complete list but it should help you start thinking about your assessment.

#### **FINANCIAL FACTORS**

**General question:** Are we going to have enough cash to cover our costs?

#### **Specific questions:**

Donations	Do we expect people to make fewer/smaller donations to us?
Grants	Have our funders agreed to provide more funding? Do we have any multi-year grants? Could this change? Are there any new grant schemes we could apply for?
Membership fees	Will our members be able to pay their fees? Do we expect any members to leave?
Staff costs	Are we going to be able pay employees on time?
Fixed costs	Do we have any recurring costs that we have to cover (eg. rent, rates, electricity)? Is there anything we can do to reduce these costs?
Loans	Do we have any large loans and when are they due? Are there any rules on our loans (loan covenants) which we are at risk of breaking?
Fundraising	Do we need to change the way we fundraise? Are we still comfortable with street collections?
Cash reserves	Do we have a rainy-day fund to help us cover our costs?
Credit facilities	Do we have an overdraft account with our bank we can use?
Financial assistance	Are there any government assistance schemes we qualify for?



You should also think about how any other non-cash factors could affect your entity's ability to continue operating, for example, access to volunteers.



Remember to write down all the factors you considered when assessing your entity's ability to continue operating. This is particularly important if you have your performance report audited because your auditor will need to understand how you came to your conclusion.

**OPERATING FACTORS:**

**General questions:** Are we going to be able to keep doing things in the same way?  
 What do we need to change?  
 Is there anything stopping us from making the necessary changes? Is it too costly?

**Specific questions:**

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|---------------|--|
| Contracts     | Are we reliant on any large contracts?<br>Is there a risk that we could lose those contracts?                                      |
| Suppliers     | Are we reliant on any large suppliers?<br>Is there a risk they will close down?<br>What would we do if they had to?                |
| Staffing      | Are we reliant on staff or volunteers?<br>Will we be likely to retain our staff?<br>How could we adapt if we had fewer volunteers? |
| Logistics     | Has anything affected our ability to provide our services?<br>Is there another way we can provide them?                            |
| Collaboration | Can we work with others?<br>Would it be easier or less costly to do so?  |
| Opportunities | Is there another way we can fulfil our purpose?<br>Are there any opportunities to offer new or different services?                 |

**LEGAL FACTORS**

**General question:** Are we able to continue operating in the current legal environment?

**Specific questions:**

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|-------------|--|
| Legislation | Have there been any changes in law that impact us?<br>What do they mean in practice? |
| Regulation  | Have any new regulations been introduced that affect us?                             |

## Reporting on your entity's ability to continue operating



### What information do we need to include in our performance report?

What you need to say in your performance report will depend on the outcome of your assessment of your entity's ability to continue operating. People reading your performance report understand you can't predict the future, but they do expect you to be clear and honest about your conclusion.

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On the next page we have described what you will need to report depending on the outcome of your assessment.



### What if something happens after the end of our financial year?

If something significant happens between the end of your financial year and when your performance report is approved at your annual general meeting, you are required to:

- describe what happened;
- estimate the financial effect of the event (if possible); and
- explain the effect on your entity's ability to continue operating (if any).

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You should also revise your cash flow forecast and extend it further into the future. A good rule of thumb is at least 12 months from the date of the event. Think about whether your revised forecast changes your conclusion.

For example, one of your funders may have agreed to provide an additional grant or your landlord may have agreed to provide you with a rent holiday. Both of these things could make you more confident about your ability to continue operating.



*See paragraphs A33—A35, and A208 of the Tier 3 Standard*





If you decide that your entity **does have** the ability to continue operating, you are required to state this in your performance report as part of your statement of accounting policies. The Tier 3 template available on our website includes the following example under the heading “basis of preparation”.

**Basis of Preparation\***

[Name] has elected to apply PBE SFR-A (NFP) Public Benefit Entity Simple Format Reporting - Accrual (Not-For-Profit) on the basis that it does not have public accountability and has total annual expenses of equal to or less than \$2,000,000. All transactions in the Performance Report are reported using the accrual basis of accounting. The Performance Report is prepared under the assumption that the entity will continue to operate in the foreseeable future.



If you are **uncertain** about whether your entity has the ability to continue operating, then you should:

- state that you think your entity has the ability to continue operating, as above; and
- explain how you came to that conclusion and why you are uncertain

It is particularly important to focus on the key factors you considered in reaching your conclusion. Try to support your explanation with information such as your total cash reserves, whether others have agreed to provide support (including government) and plans you have made to change how you do things.



If you decide that it's **unlikely** your entity has the ability to continue operating or you **intend to cease operating (“wind-up”)**, you are required to:

- state that in your statement of accounting policies; and
- explain the reason why.

You are also required to consider whether this means that you should be recording anything in your performance report at a different amount. You may need to report some of your assets at the amount you could sell them for, rather than what you paid for them. Some of the more common things that need to be checked include:

- vehicles;
- office equipment such as computers and furniture;
- sports equipment; and
- inventory or stock on-hand.



See paragraphs A10 and A210 of the Tier 3 Standard



## *Other things for you to think about*

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**Do we need to include the impact of COVID-19 in our statement of service performance?**

While you're not specifically required to report on COVID-19, if your services had to change in response to the pandemic, it can be helpful to your readers to explain it in here.

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For example, in response to COVID-19 you may have had to reduce, increase, or provide new services.

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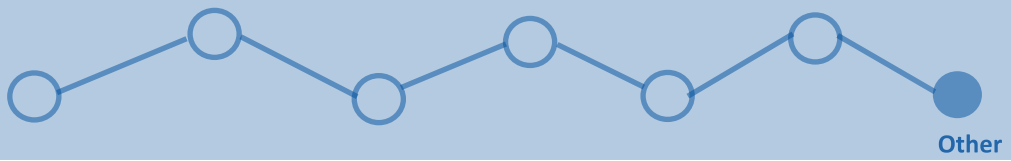
**What should we do to get ready for our audit?**

Your auditor is likely to ask you to provide evidence that supports your assessment of your entity's ability to continue operating.

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While auditors may request many different types of evidence, your cash flow forecast will often be an important piece of evidence they rely on. Make sure it covers a period of at least 12 months from the expected date of your audit report. Also make sure it's adjusted for your answers to the types of questions included in the previous sections and you write down how you arrived at the numbers in your forecast.

We recommend talking to your auditor early so you know what they will expect to see.



### Where can I go for more information on reporting or COVID-19

More information on preparing your performance report can be found on the [XRB website](#).

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Our [Tier 3 not-for-profit entity standard page](#) includes links to the standard, explanatory guidance, and template performance reports.

We also have a [dedicated hub](#) of information related to COVID-19 which contains links to other resources.



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